

*Operations Summary  
California Public Employees' Retirement System  
Year Ended June 30, 2002*



Working for You

## CalPERS Profile

The California Public Employees' Retirement System (CalPERS) is the nation's largest public pension fund and the second largest in the world, with assets at June 30, 2002 of approximately \$142 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to more than 1.3 million people and more than 2,500 public employers. The System also operates eight regional

offices located in San Francisco, Glendale, Orange County, Fresno, Sacramento, San Bernardino, San Diego, and Mountain View.

CalPERS is led by a 13-member Board of Administration, consisting of member-elected, appointed, and ex officio members.

Our membership consists of 982,177 active and inactive members from the State, school districts, and local public agencies, and 381,746 retirees, beneficiaries,

and survivors. Established by legislation in 1931, the System became operational in 1932 for State employees only. In 1939, public agencies were allowed to contract with CalPERS to provide retirement benefits for their employees. We began administering health benefits to State employees in 1962 under the Public Employees' Medical and Hospital Care Act. Local public agencies joined in our health program on a contract basis five years later.

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*Year Ended June 30, 2002*

# Working for You

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Dr. William Dale Crist, President



# President's Message

Dear Friends:

What does it take to run an excellent pension and health administration organization? It takes high quality people, high quality programs, good attitudes regarding service, and a solid set of values.

All of these elements came together for us at CalPERS during 2001, a year made especially challenging by the sobering reality of September 11.

The impact of 9/11 continues to reverberate throughout our economy. The threat of war with Iraq has made us uneasy about the future. Adding to the uncertainty, corporate fraud and visibly defective corporate governance reached scandalous proportions early in 2002.

The resulting destruction of confidence in the U.S. financial markets drastically reduced the value of stocks and bonds held by investors large and small. While stock prices plummeted, health care costs escalated at an alarming rate, making it increasingly difficult to provide affordable high quality health care. The conflicting political, social, and economic challenges are daunting.

With all these challenges before us, I am proud to say it was still a remarkable year for CalPERS, and I am pleased to present the CalPERS Operations Summary and Comprehensive Annual Financial Report. The hard work, ongoing efforts, and successes of the CalPERS team are detailed here on the pages of this report.

With the world around us changing so rapidly and so significantly, we made the special effort necessary to stay focused on the work immediately before us. Our first and foremost responsibility is to the members and employers we serve – protecting our retirement benefit assets, advancing our strategic initiatives, and staying true to our ongoing leadership role in retirement administration, investment management, and health benefit design and delivery.

Like most large pension funds, we did not realize an overall gain in our investment portfolio during

the 2001-02 period. But, because of a strong diversification strategy and an exceptional professional investment staff, we managed to do better than most pension systems holding more than \$1 billion in assets – and better than the stock market overall – averaging a negative 6.1 percent return at year end. Our real estate investments, which generated almost an 11 percent positive return, helped reduce the Fund's overall losses.

In providing health care insurance for our members, the Board and professional staff used every type of leverage available to negotiate the most affordable premiums possible while maintaining quality and holding the line against copayment increases.

We are proud of our customer service improvements. We've expanded our "e-business" options for both members and employers, launched a Customer Call Center which includes a new voice recognition system, and re-engineered several of our business processes that make it possible to pay benefits to members more quickly.

As we look to the new fiscal year, we will continue to stay the course in our core business areas – administering retirement and health benefits and services on a day-to-day basis — in the most effective way possible. CalPERS

will continue to fight for corporate reforms, assisting in bringing investor confidence back to the financial markets. We will continue to improve our performance in providing customer service by developing multiple, convenient ways for our customers to conduct their CalPERS business transactions. We plan to expand our education and member and employer training opportunities. We will also expand our work on the design and implementation of a health benefits program that can deliver quality, affordable care to best meet our members' needs, and their pocketbooks. We will, of course, stay diligent in our efforts to manage our investment risks and to grow the Fund prudently.

The work ahead of us is demanding and exciting, and it is a mission that we are proud to be engaged in on behalf of our members.

Respectfully submitted,



**William Dale Crist, President**  
CalPERS Board of Administration



# Working For You

## Introduction

We have all been witnesses to the dramatic changes that took place in our country and the world in the last year. At CalPERS, we have seen the results in many ways – in the daily work we do for you, in our investment returns, and in our customer service improvements. CalPERS was not spared from the downturn in the world's equity markets.

But we've worked diligently to ensure CalPERS remained financially stable, our member benefits were secure, and our services continued to improve.

How did we do it? We succeeded by having excellent, dedicated employees motivated to do the right thing, by having the protections in place to protect the Fund's assets, and by remaining committed to our focus of providing retirement and health security to all those we serve.

You will read about some of the advances we have made during the year. You'll see some of our major achievements highlighted in pictures and words. And, we'll tell you about some areas where we still have more work to do.

Our goal is to anticipate your needs, respect your circumstances, create innovative solutions, and achieve superior results. We'll do this by staying on task and working for you, our customer.

# Financial Highlights

## Public Employees' Retirement Fund <sup>1</sup>

(Dollars in Thousands)

	2002	2001
<b>Assets</b>		
Cash & Cash Equivalents	\$20,537	\$25,127
Investments, at Fair Value	156,417,672	170,119,050
Receivables	5,604,611	3,458,569
Other Assets	123,820	113,970
<b>Total Assets</b>	<b>\$162,166,640</b>	<b>\$173,716,716</b>
<b>Liabilities</b>	<b>\$19,379,422</b>	<b>\$17,442,319</b>
<b>Net Assets Held in Trust for Pension Benefits</b>	<b>\$142,787,218</b>	<b>\$156,274,397</b>

## Additions & Deductions

	2002	2001
<b>Additions</b>		
Member Contributions	\$2,154,742	\$1,766,256
Employer Contributions	800,964	321,619
Net Investment Income	(9,704,478)	(12,255,822)
Other	4,686	7,481
<b>Total Additions</b>	<b>(\$6,744,086)</b>	<b>(\$10,160,466)</b>
<b>Deductions</b>		
Retirement, Death & Survivor Benefits	\$6,431,019	\$5,792,949
Refunds	103,386	128,866
Administrative Costs	208,688	183,866
<b>Total Deductions</b>	<b>\$6,743,093</b>	<b>\$6,105,681</b>
<b>Decrease in Net Assets Held in Trust for Pension Benefits</b>	<b>(\$13,487,179)</b>	<b>(\$16,266,147)</b>

Complete financial information on all the funds administered by CalPERS can be found in the Comprehensive Annual Financial Report for the year ended June 30, 2002.

### NOTE:

<sup>1</sup> Differences in the amount shown for investment assets in these Financial Highlights and the Investment Portfolio amount reported in the Investments Section of this summary are due to differences in reporting methods. In accordance with Governmental Accounting Standards Board Statement No. 28, the financial statements include securities lending collateral. Also, net investment receivables/payables are not included here.



Back row, standing, left to right: Sidney L. Abrams, Sean Harrigan, Charles P. Valdes, Rob Feckner, Michael Flaherman, Mike Quevedo, Jr., and Robert F. Carlson. Front row, seated, left to right: Kurato Shimada, Ted Eliopoulos (representative for Philip Angelides), Kathleen Connell, Marty Morgenstern, William Dale Crist, and Willie L. Brown, Jr.



# CalPERS Board of Administration



**William Dale Crist,  
President**

Employee Member  
(elected by State members)  
Professor, CSU Stanislaus  
*Term Ends: January 15, 2003*

**Robert F. Carlson,  
Vice President**

Retired Member  
(elected by retirees)  
Retired, Chief Counsel,  
Department of Transportation  
*Term Ends: January 15, 2004*

**Sidney L. Abrams**

Official of Life Insurer <sup>1</sup>  
Trustee, United Food and  
Commercial Workers Unions and  
Employers Midwest Health  
Benefits Fund and Pension Fund  
*Term Ends: January 15, 2005*

**Philip Angelides**

State Treasurer  
Ex Officio Member

**Willie L. Brown, Jr.**

Elected Official of Local  
Government <sup>1</sup>  
Mayor of San Francisco  
*Term Ends: January 15, 2003*

**Kathleen Connell**

State Controller  
Ex Officio Member

**Rob Feckner**

Employee Member  
(elected by school members)  
Glazing Specialist, Napa Valley  
Unified School District  
*Term Ends: January 15, 2007*

**Michael Flaherman**

Employee Member (elected by  
public agency members)  
Economist, Bay Area Rapid  
Transit  
*Term Ends: January 15, 2003*

**Sean Harrigan**

State Personnel Board Member  
(designated by the State  
Personnel Board)

*Term Ends: Serves at the pleasure  
of the State Personnel Board*

**Marty Morgenstern**

Director, Department of  
Personnel Administration  
Ex Officio Member

**Mike Quevedo, Jr.**

Public Representative <sup>2</sup>  
*Term Ends: January 15, 2004*

**Kurato Shimada**

Employee Member  
(elected by all members)  
Retired, Supervisor of Operations,  
Oak Grove School District  
*Term Ends: January 15, 2006*

**Charles P. Valdes**

Employee Member  
(elected by all members)  
Counsel, Department of  
Transportation  
*Term Ends: January 15, 2006*

**NOTES:**

<sup>1</sup> Governor appointee.

<sup>2</sup> Appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.

## CalPERS Board Committees

*In addition to their regular duties, Board Members also serve on permanent and ad hoc committees to review specific programs, projects, or issues and make recommendations to the Board. The following committees were active as of June 30, 2002.*

### Benefits & Program Administration

**Kurato Shimada, Chair**

**Sidney L. Abrams, Vice Chair**

Robert F. Carlson

Kathleen Connell

William D. Crist

Rob Feckner

Michael Flaherman

Sean Harrigan

Marty Morgenstern

This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

### Health Benefits

**Rob Feckner, Chair**

**Kurato Shimada, Vice Chair**

Sidney L. Abrams

Philip Angelides

Kathleen Connell

Sean Harrigan

Marty Morgenstern

Charles P. Valdes

Vacancy

This committee oversees the administration of the Public Employees' Medical & Hospital Care Act program and the Public Employees' Long-Term Care Act program.

### Performance & Compensation

**Charles P. Valdes, Chair**

**Robert F. Carlson, Vice Chair**

William D. Crist

Rob Feckner

Michael Flaherman

Kurato Shimada

Vacancy

This committee studies and evaluates compensation mechanisms and criteria, develops policies and procedures, and makes recommendations to the Board concerning compensation of key personnel.

### Finance

**Robert F. Carlson, Chair**

**Kathleen Connell, Vice Chair**

Philip Angelides

William D. Crist

Michael Flaherman

Charles P. Valdes

Vacancy

This committee provides financial oversight on all budget matters, evaluates funding alternatives, oversees preparation and recommends approval of the CalPERS budget, and oversees the CalPERS annual and periodic audits by both internal and external audit units.

**Investment**

Michael Flaherman, Chair  
 Sean Harrigan, Vice Chair  
 Sidney L. Abrams  
 Philip Angelides  
 Willie L. Brown, Jr.  
 Robert F. Carlson  
 Kathleen Connell  
 William D. Crist  
 Rob Feckner  
 Marty Morgenstern  
 Mike Quevedo, Jr.  
 Kurato Shimada  
 Charles P. Valdes

This committee reviews investment transactions, the investment performance of both internal and external managers, and establishes investment policy and strategy.

**Investment Policy Subcommittee**

Charles P. Valdes, Chair  
 Philip Angelides, Vice Chair  
 Robert F. Carlson

This subcommittee conducts an inventory of all existing investment policies, procedures, and guidelines for review by the Investment Committee and reviews and recommends revisions to these on a priority basis. It is also charged with developing a manual of policies, procedures, and guidelines, and a process for periodic revisions.

**R Street Subcommittee**

Charles P. Valdes, Chair  
 Robert F. Carlson, Vice Chair  
 William D. Crist  
 Rob Feckner  
 Michael Flaherman

This subcommittee oversees the CalPERS headquarters expansion project, including the selection of contractors, approval of building designs, and approval of expenditures and budgets.

Back row, standing, left to right: Allen D. Feezor, Ron Seeling, James H. Gomez, Patricia K. Macht, Mark J.P. Anson, and Robert Aguallo. Front row, seated, left to right: Vincent P. Brown, Robert D. Walton, Kayla J. Gillan, James E. Burton, and Barbara Hegdal.



# CalPERS Staff

## Executive Staff

### **James E. Burton**

Chief Executive Officer  
[through August 2002]

### **James H. Gomez**

Deputy Executive Officer  
[through August 2002]

### **Robert Aguallo**

Assistant Executive Officer  
Investment Office

### **Mark J.P. Anson**

Chief Investment Officer  
Investment Office

### **Vincent P. Brown**

Assistant Executive Officer  
Financial & Administrative Services

### **Allen D. Feezor**

Assistant Executive Officer  
Health Benefit Services

### **Kayla J. Gillan**

General Counsel  
[through August 2002]

### **Barbara Hegdal**

Assistant Executive Officer  
Member & Benefit Services

### **Patricia K. Macht**

Chief  
Office of Public Affairs

### **Ron Seeling**

Chief Actuary  
Actuarial & Employer Services

### **Robert D. Walton**

Assistant Executive Officer  
Governmental Affairs, Planning &  
Research

## Division Chiefs

### **Denise Arend**

Investment Operations  
[through July 2002]

### **Tom Britting**

Office of Audit Services  
[through December 2002]

### **Ralph Cobb**

Acting Chief, Self-Funded Programs

### **Jack Corrie**

Information Technology Services

### **Tom Fischer**

Health Benefit Services

### **Tim Garza**

Enterprise Modeling & Management

### **Allen Goldstein**

Change Management

### **Pat Harris**

Branch Development Center

### **Linda Hoff**

Office of Policy & Program  
Development

### **Charles Hwu**

Administrator, Data Administration

### **John Korach**

Fiscal Services

### **Ron Kraft**

CalPERS Customer Call Center

### **Ken Marzion**

Actuarial & Employer Services

### **Peter Mixon**

Deputy General Counsel, Legal  
Office

### **Dave Mullins**

Supplemental Savings Program

### **Rick Nelson**

Operations Support Services

### **Chris Nishioka**

Benefit Services

### **Michael Ogata**

Planning & Research

### **Tom Pettey**

Human Resources

### **Diana Proctor**

Headquarters Expansion Project

### **Kathy Vaughn**

Member Services

### **Nancy Welsh**

Health Program Development

### **Casey Young**

Office of Governmental Affairs

## Regional Office Managers

### **Anita Commer**

San Francisco

### **June Copple**

San Bernardino

### **Laura Duran**

Orange County

### **Elaine Edwards**

San Diego

### **Debra Gibson**

Sacramento

### **Edith Mercer**

Glendale

### **Elwin Nash**

Mountain View

### **Steve Pietrowski**

Fresno

*“We stayed true to our business plan –  
focusing on managing benefits, providing quality  
service, and prudently managing our assets.”*



The Year in Review





*With so much going on in the world around us, we were not deferred from our purpose – realizing achievements in our customer service improvement efforts. For example, we developed new business processes that improve how quickly we're able to pay benefits; launched our new Customer Call Center; developed new online business services for members; and continued our work to expand employer and member education opportunities.*

Fiscal year 2001-02 was far and away one of the most unusual and challenging years in recent history. It seemed like the world literally changed over night with the events of September 11, 2001. What followed was a war in Afghanistan, an escalation of the conflict in the Middle East, and then the bombshell revelations of corporate fraud – so serious that corporate reforms were signed into law with bullet-like speed by the Congress and the President. The economy sputtered all year long, and the health care purchasing marketplace emerged from its most difficult year in recent memory.

The people of CalPERS honored the victims of 9/11, especially our fellow public servants who gave their lives in an attempt to save others. While the news of this event and other major developments concerned us, we pressed on, reminded of the American spirit behind meeting our challenges.

CalPERS was most directly affected by the disclosures of alleged fraud in Enron, WorldCom, and by allegations involving corporate auditors, Arthur Anderson. While our attention was focused on managing in these uncertain

times, we stayed true to our business plan – focusing on managing benefits, providing quality service, and prudently managing our assets.

Our blueprint for managing into the future is our Three-Year Business Plan. This gives us the needed direction to better anticipate opportunities, improve our services, and meet – and even exceed – our customers' needs. It helps us manage our resources more effectively and ensures that we have the capacity to support both our core business processes and our strategic initiatives.



## Managing Benefits

A key focus of our benefits management efforts continues to be the re-engineering of our business processes to provide faster, more reliable service to our members. We are taking a closer look at how we do our work, and finding top quality, more efficient ways to meet ongoing demands. This past year several of our processes were simplified, including pre- and post-retirement death benefit processing, retirement allowance adjustments, and community property claims.

In addition to these service level improvements, our core work continued – making sure members received their benefits when due. In fiscal year 2001-02, CalPERS paid out more than \$6.4 billion in retirement, death, and survivor benefits, up from \$5.8 billion the previous year. Staff processed 18,427 new service retirements and 2,402 disability retirements during the year. Some 97 percent of our newly retired members received their first benefit check within 30 days of their retirement date. In addition, we processed 23,415 requests for refunds and got those refunds to members within 30 days. Staff also completed 4,033 disability retirement determinations and 33,600 requests for direct deposit of retirement checks.

During the year, staff processed more than 70,000 retirement

estimates, completed more than 25,000 service credit cost calculations, and processed 13,700 service credit elections. We provided assistance to more than 42,000 visitors to our Regional Offices, completed 697 retirement sessions at employer sites, and conducted well over 1,900 financial planning seminars and retirement planning workshops.

A highlight this year was providing more than 16,000 active State members and retirees a one-time opportunity to change their current payment option to convert their Second Tier service through the benefit equity program. Several years ago, the Governor and Legislature passed legislation that allowed our more than 50,000 Second Tier members to elect to move to the First Tier retirement formulas. During the year, the Board of Administration allowed those members who had already made their Second Tier election – and those who still plan to do so in the future – the option to pay for their service purchase through a 180-month payment schedule. This extended payment option made it much easier for many members to take care of this service credit conversion.

## Providing Customer Services

CalPERS takes great pride in our new Customer Call Center. This is one more step in our evolution of a centralized customer contact

### Retirement Program Highlights

- **982,177** active & inactive members
- **381,746** retirees, beneficiaries, & survivors
- **20,829** new retirees
- **\$6.4 billion** paid in benefits
- **2,519** public agency employers (including school districts)

center. During the year, we responded to some 718,000 calls from members. An additional 228,000 calls were handled during the health open enrollment period.

This year, we added an Interactive Voice Response (IVR) system, and enhanced it with voice recognition. Now callers can talk to the system to request information rather than pushing buttons on their phone, making it easier for them to access the services they need. The IVR system can be accessed 24 hours a day from any telephone. Publications can be requested and frequently asked questions or special announcements on topics such as the issue date of benefit checks, refunding member contributions, or purchasing service credit can be answered, without waiting for a CalPERS representative.

In the Spring of 2002, we added enhancements to the IVR to include speech recognition for the main phone menu and a customer satisfaction survey. The computer matches spoken words against a database dictionary, and it takes into account different accents, gender, tone of voice, and background noise to arrive at the most likely meaning of a caller's spoken response. Elimination of confusing prompts provides quicker, more accurate service and improves customer satisfaction.

We still offer callers personal service and now, behind the voice

on the telephone is a brand new tool that is enabling our Call Center representatives to provide exceptional service – member information on their desktops. In years past, it could be two or three days before information could be researched and forwarded to the member. During the year, as part of our Records Retention Project, more than 52 million member documents were “imaged” into a digital-imaging environment. As a result of that enormous effort, when members call now, staff have instant, online access to these documents and have the ability to use workflow technology to streamline request processing.

Our telephone service is one way in which members can conduct CalPERS business. The other way is by accessing our Web site, which this year brought more than 25 million visits. During the year, we added three new self-service tools. They included requesting official CalPERS retirement estimates, registering for a CalPERS seminar or workshop, and ordering forms and publications online. These joined our existing stable of electronic services including “View Your Annual Member Statement,” the Retirement Planning Calculator (which can automatically add personal member account information), and the Service Credit Cost Estimator. The popularity of our online services is growing and we look forward to the launching our new “Change

Your Address” tool in November 2002. All our electronic services are offered in a secure environment and require members to register for a personal identification number to ensure protection their electronic information assets.

CalPERS takes our duty to educate our members seriously. One high profile event – Retirement Planning Month – is held each year to educate members about the value of their CalPERS defined benefit plan, their Social Security benefits, and their options for growing their own personal savings. This year, the theme was “Building a Better Bridge for Tomorrow.” More than 121,000 members were reached through this campaign. One of the highlights of the month-long campaign was three separate retirement fairs held throughout the State. Members were able to meet with CalPERS staff to talk about their retirement benefits and financial planning opportunities, and to learn more about our other programs and services, such as the Member Home Loan and Long-Term Care programs.

Another major educational tool launched this past year was the new Online Financial Planning Center on the CalPERS Web site. This electronic classroom provides five different financial planning courses from cash and risk management to determining your investment type and developing investment strategies. Visitors can also find

help on estate, insurance, and retirement planning. There are also several “quick reports” that can be used. Members can even contact a financial advisor online or request a personal financial plan.

### CalPERS Supplemental Savings Programs

The CalPERS Public Agency 457 Deferred Compensation Program, which is available to local public agency and school members, welcomed an additional 2,257 new participants and 42 new agencies – now totaling more than 12,000 members and 414 employers. Assets totaled \$226.6 million at year end, a 16.1 percent increase from the previous year. Distributions and withdrawals paid to participating plan members were \$10.4 million.

The State Peace Officers’ and Firefighters’ Defined Contribution Program realized plan growth for nearly 33,000 participants. This employer-paid program is available to certain eligible State safety members. Net assets increased by 31.3 percent to \$98.7 million at June 30, 2002. Benefits paid out during the year were \$3.4 million, and contributions increased 2.8 percent to \$34.2 million.

The CalPERS Supplemental Contributions Program is a voluntary supplemental savings scheme available to State members and is entirely member funded. Contributions are made on an

after-tax basis. At the end of fiscal year 2001-02, there were 1,122 participants and assets were valued at \$19.1 million. Contributions were \$1.1 million for the year, and \$1.3 million was paid in participant withdrawals.

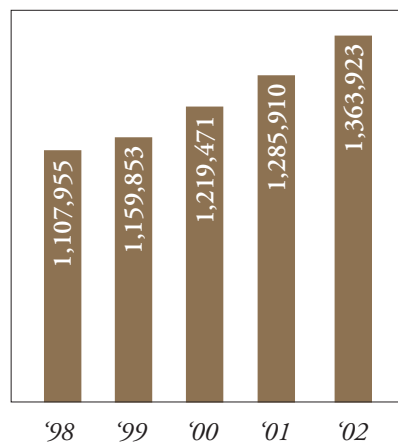
### CalPERS Member Home Loan Program

This innovative home loan program is administered by more than 70 lending institutions with nearly 800 branch locations in the State and across the nation. The Program offers CalPERS members competitive loan rates, a free 60-day interest rate lock, and a 100 percent financing option (a combination mortgage loan and personal loan secured against the member’s retirement contributions). There are also several options to help first-time buyers and low- to moderate-income purchasers.

During the year, the program purchased more than 24,500 real estate loans totaling more than \$4.2 billion, and 1,983 personal loans of \$16.0 million. This is the highest volume of loans purchased in a single fiscal year since the inception of the program, which can be attributed to the lowest mortgage interest rates available in more than 30 years. The 15-year conforming rate was 5.625 percent and 6.25 percent for the 30-year option during the fourth quarter of 2001-02.

### Total CalPERS Membership

*Five-Year Review*



## Assisting Employers

The second annual CalPERS Employer Conference was a tremendous success this year, and it provided a unique opportunity to establish better relationships with the employers who administer our benefits to members. The 2001 conference, themed “Working Together” took place in Anaheim and was attended by approximately 500 employer representatives.

The conference focused on education, explaining how current CalPERS policies and procedures work, and provided sessions designed to generate discussion and to hear from employers on how CalPERS can enhance or develop new services. Topics included health care, the volatile stock market, negotiations over improved retirement benefits, and how CalPERS should continue to deliver services in the future. Our Actuarial workshops also proved to be highly popular with attendees. Other break-out sessions covered up-to-date information on benefit improvements, customer service enhancements, current CalPERS projects underway, and future business initiatives. Our latest technological advances were also exhibited at our Technology Center, a hands-on computer lab.

Our Actuarial and Employer Services staff also reached out to employers at their workplace with training and education. Some 36

new public agencies were added to the CalPERS family. And this past fiscal year, a special effort was undertaken to educate State government agencies and campuses of the California State University system. The Employer Education Unit developed the first CalPERS State Handbook and began workshops for State employer representatives. In addition, staff conducted 140 public agency workshops to 460 agencies, reaching 1,611 attendees.

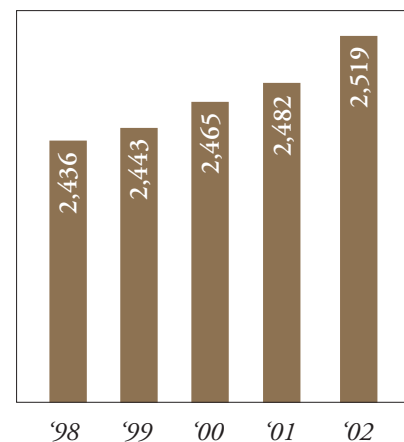
Actuarial staff completed and mailed 100 percent of the 1,874 public agency actuarial valuation reports by October 2001. The State and school valuations were completed by April 2002, as well as valuations for the Legislators’ Retirement System, the Judges’ Retirement System, the Judges’ Retirement System II, the Volunteer Firefighters’ Length of Service Award System, and the 1959 Survivor Program.

CalPERS staff processed more than 180,000 member enrollment forms submitted by employers, processed more than 40,000 payrolls, and completed more than 2,100 contract amendment cost analyses and 400 contract amendments. Staff maintained service levels all year long in spite of a 30 percent increase in workload and increased complexities created for valuations by new legislation.

ACES – our Automated Communications Exchange

## CalPERS Participating Public Agencies

*Five-Year Review*



System – which allows employers to electronically submit health benefit, membership, and payroll transactions via the Internet, continued to expand with 917 new participating employers. Employers connected to ACES transferred 5,204 payroll files directly to CalPERS during the year. This online business system reduces the volume of paper CalPERS receives, improves the timeliness and accuracy of employer transactions, and results in reduced time for members to receive benefits. For example, because of ACES members now receive health plan identification cards within seven to 10 business days, instead of six to eight weeks.

This past year, we also conducted our first employer survey. The general purpose of the survey was to measure satisfaction about various services we offer. Overall, employer customer satisfaction is high – in some cases, exceptionally high – with our current practices, policies, procedures, and programs. However, the survey did identify opportunities to improve or expand our employer services, mainly in our telephone service and service credit resolutions.

### **Improving Our Organizational Effectiveness**

Technological improvements are the linchpin that enable us to deliver quality service to our employers and members into the

future. For several years, CalPERS has been phasing in our corporate database, COMET. As a result, the ability to make changes and corrections to member accounts is now easier and happens in a more timely fashion. In February 2002, we implemented the fourth phase, a participant registration system that enables us to register and enroll members into the CalPERS benefit programs. It also provides information on refunds, redeposits, retirements, reinstatements, reciprocity, and service credit elections, as well as historical information for community property, State First Tier elections, and account holds and liens. We also added a new employer contracts system, which maintains all employer organization data, including reciprocal agencies.

Technological improvements in how we manage our investments will also catapult CalPERS to a new level, with the implementation of a Fixed Income Trading System (FITS) for all fixed income investments, both internally and externally managed. FITS enables our Investment staff to automate, streamline, and re-engineer our business processes, will help us be more effective and efficient in making decisions about investments, and ultimately, enable us to save millions of dollars a year in managing investments. Similarly, another Investment project – Straight

Through Processing – will enable us to automate many manual processes and increase operational efficiencies for our trading and settlement processes. This technology will sharpen our competitive edge and reduce risk.

Information security is a top priority at CalPERS. A special office is devoted to this function so we can ensure all our information assets are protected and member personal information remains secure. During the year, through efforts by our employees and with the help of anti-virus software, more than 2,556 viruses were prevented from encroaching our computer systems.

Member assets are also protected through our internal and field audit programs undertaken at CalPERS. Through the Office of Audit Services, we can be assured that our programs, policies, and other legal requirements are met across the board. For example, last fiscal year, CalPERS auditors completed 46 public agency audits, provided consultations on 17 more projects, conducted 34 internal audits, and completed nine health plan and four real estate compliance audits.

CalPERS is a major source of contracts for many businesses. To ensure that our procurement processes are widely known by the business community, last year CalPERS formed the Business

Connection, an aggressive outreach and marketing program geared toward potential business partners. A new CalPERS On-Line area now also lists all current available business opportunities and helps keep interested businesses in the know so they can bid on these contracts.

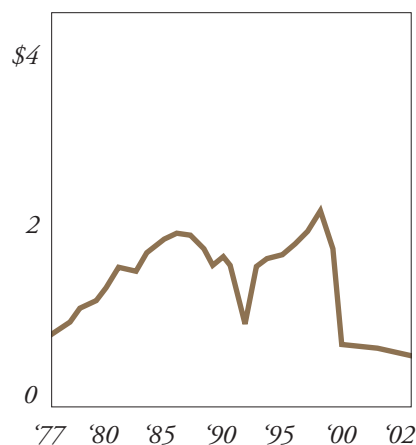
At CalPERS, our people are also one of our greatest assets. To be able to provide quality services to our members and employers, you need to have quality staff, dedicated to meeting the CalPERS vision. We continued training our employees through several means. Six CalPERS foundational courses that cover knowledge essential for success as a CalPERS employee were developed last year and more than 75 of our employees have successfully completed each of the six courses to become the first graduates of the program.

During the year, we also continued expansion of our onsite Learning Center. Staff can utilize more than 1,100 video- or audio-based courses, or sign-up for computer-based training, as well as external training opportunities. Additionally, 100 of our leaders completed a second successful 360 Leadership Feedback Program series. With the remaining staff leaders still to complete the program during the next fiscal year, the benefits are already apparent, as the results to date are even better than last year.

As has been our practice for several years, CalPERS staff once again gave back to our communities and exceeded past year totals by donating more than 83,000 pounds of food to the State Employee Holiday Food Drive (the highest amount ever donated by any State agency), made more than \$125,000 in charitable contributions, donated

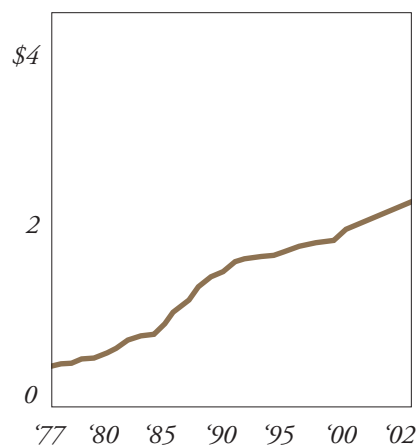
### CalPERS Income from Employer Contributions

25-Year Review (Dollars in Billions)



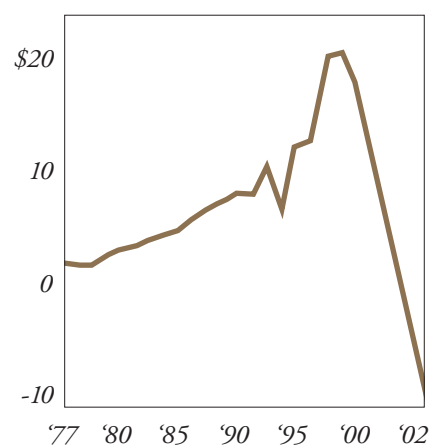
### CalPERS Income from Member Contributions

25-Year Review (Dollars in Billions)



### CalPERS Income from Investments

25-Year Review (Dollars in Billions)





395 pints of blood with our blood drive throughout the year, and responded to a September 11<sup>th</sup> special blood drive with another 70 pints.

### Headquarters Expansion

CalPERS broke ground in October 2001 on our Headquarters Expansion Project, adjacent to our existing building. The mixed-use complex will include a building with a six-story west wing and a four-story east wing, an 18,000-square foot public courtyard, parking, retail shops, a restaurant, and the relocation of our day care center. The office space will provide room for our staff as CalPERS continues to grow to meet our member needs. It will also make a significant contribution to the Sacramento community, creating a neighborhood that connects work and living spaces in a way that improves the city. The CalPERS plan met with approval by the city, residents in nearby neighborhoods, and is consistent with the city's R Street corridor planning policy, including 180,000 square feet of residential development on R Street between 3rd and 7th Streets.

### Feedback & Recognition

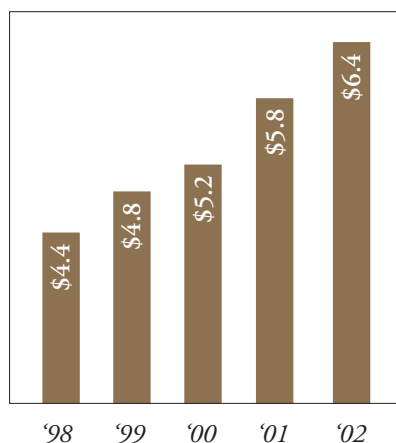
The progress we make depends mightily on a highly performing, motivated workforce. And if the 2001-02 employee opinion survey is any indication, our employees

outperform other organizations – public or private – in their commitment to the CalPERS mission. This year, survey results were not only compared to responses from our last survey, but also against comparable results from other public and private sector organizations.

The survey studied 16 different “dimensions,” from our organization's strategic direction, job satisfaction, supervision, and working conditions to pay and benefits, training and development opportunities, and employee commitment. Overall, survey results presented a positive picture of CalPERS. Responses showed that staff are clear and committed to the strategic direction of our organization and have a good understanding of our business objectives. Staff gave our leaders high marks for responsiveness to employee needs. They felt they were treated with respect from supervisors and gave working conditions high marks. Results also showed that staff have a clear understanding of what was expected of them. They reported that they are kept informed on matters impacting their work and were satisfied with our appreciation and recognition efforts.

### CalPERS Benefits Paid

*Five-Year Review (Dollars in Billions)*





more opportunities and counseling on career development, expanding our cross-divisional communication efforts, and emphasizing accountability in achieving successful results. Steps are already underway to revamp our employee annual evaluation process to include discussion on employee growth and training, and to solicit more interaction between employees and supervisors in completing evaluations.

At a ceremony held in March 2002, 57 CalPERS employees were honored as the 2002 APEX nominees. The APEX (Achieving Performance EXcellence) is our peer-driven formal recognition program that acknowledges those employees who demonstrate commitment to the CalPERS core values, our customer service

principles, excellent technical and interpersonal skills in ongoing pursuit of self-development, and to the overall success of CalPERS.

As an organization, CalPERS received a number of national awards for outstanding achievements again this year. The National Association for Employee Recognition honored us with their best practice award for our three-dimensional recognition award program, and our CalPERS On-Line member self-services received the “Best Solutions Award” from the 2001 Government Technology Conference.

As the nation’s largest public pension fund, it’s important that we lead the way in pension fund accounting disclosure. To this end in June of 1999, the Governmental Accounting

Standards Board (GASB) issued GASB Statement 34 requiring large governmental agencies to expand the scope of information contained in their financial condition reporting. While organizations were not required to implement GASB Statement 34 until the 2001-02 fiscal year, CalPERS elected to early adopt the new pronouncement.

CalPERS received a “Certificate of Recognition” from GASB in recognition of this accomplishment. This effort involved adding a 12-page Management’s Discussion and Analysis section to the report. We were also particularly proud to earn the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association this past year.

*“Our guidelines are clear –  
provide a program that emphasizes cost effectiveness,  
quality of care, and plan stability.”*



# CalPERS Health & Long-Term Care Report



*Facing substantial premium increases, dwindling health plan options, and increased use of services, CalPERS began work on a new program design that will deliver the best care to meet our customers' needs and their pocketbooks. At the same time, we completed difficult premium negotiations where we held the line on copayment increases and benefit design; processed almost double the amount of plan enrollment documents; improved our open enrollment materials; offered new IVR and online plan changes for retirees; completed a recovery plan that stabilized the financial reserves of our self-funded plans; and provided more plan options than ever in our Long-Term Care Program.*

### **The Health Care Escalator: Tough Market Spikes Prices**

In fiscal year 2001-02, the CalPERS health program faced one of the toughest challenges in our 40-year history. The Board of Administration grappled with substantial premium increases, and the number of affordable health plan options dwindled. The managed care model no longer restrained costs, mergers reduced price competition, and aging members used more services and prescription drugs than ever.

CalPERS and other U.S. health care purchasers faced escalating

premiums. For the 2003 coverage year, health maintenance organizations (HMOs) in the CalPERS program initially asked for rate increases of up to 41 percent.

In the spring of 2001, the CalPERS Board of Administration managed to lower the average premium increase for HMO Basic plans to 6 percent for 2002. To do that, the Board rejected initial proposals outright to pressure for lower bids later. The Board also accepted the program's first copayment hike since 1993.

Those tactics weren't feasible a year later, however.

#### **Health Program Highlights**

- 1,249,175 employees, retirees, and family member participants
- 59 percent are State members
- 41 percent are public agency and school members
- \$2.7 billion paid in annual health premiums

In negotiations for 2003, CalPERS held the line on copayments, benefit design, and service areas. But, we didn't have enough leverage to force significantly lower rates.

The Board eventually accepted premium increases averaging approximately 26 percent for HMO Basic plans and 41 percent for their Medicare-coordinated plans. They also approved rate increases of 22 percent for PERSCare and 19 percent for PERS Choice, our self-funded preferred provider organizations (PPOs). Premiums for PPO Medicare supplemental plans would go up about 6 percent for PERSCare and 5 percent for PERS Choice.

The total cost of the 2003 health program was estimated to be at \$3.4 billion compared with \$2.7 billion for 2002.

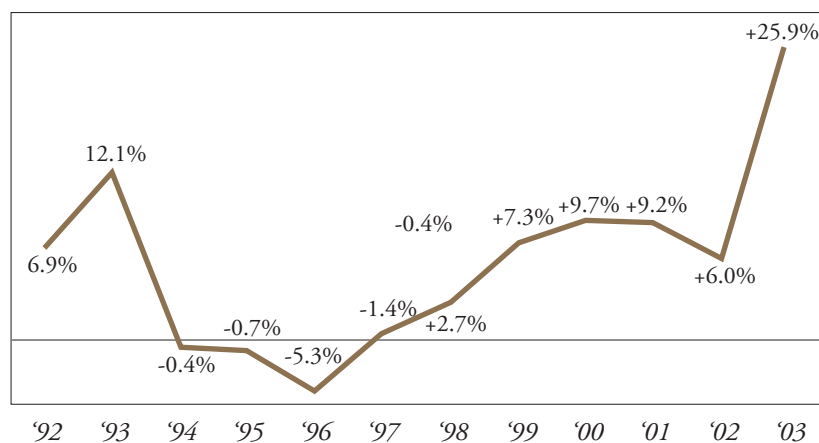
These rate increases reflected major market forces that had been simmering for years. In the mid-1990s, CalPERS led the field in obtaining relatively low premiums until costs began to rise again at the end of the decade. The burgeoning cost drivers included an aging population, demands for expensive new technology, higher hospital and prescription drug use, shrinking Medicare reimbursements, a growing number of uninsured Californians, legislative mandates, and soaring energy prices.

Significant changes also loomed for our HMO lineup in 2003. In the Spring of 2002, the Board eliminated Health Net and PacifiCare to avoid \$77 million in additional premium costs. Later, Health Plan of the Redwoods was withdrawn after it sought Chapter 11 bankruptcy protection. Another 2002 partner, Universal Care, decided to drop out, and Western Health Advantage, a small regional plan, was retained, but was closed to new members for 2003.

### Basic HMO Premium Averages

#### Percent Decrease or Increase

*Based on a weighted average of all CalPERS HMOs*



Those changes left the program with two major HMO partners – Blue Shield of California and Kaiser Permanente. Also available were PERSCare and PERS Choice and three association plans, which are also available to members who belong to these associations.

The loss of another four HMOs (four plans were discontinued the previous year) preceded the 2002 Open Enrollment drive. More

than 160,000 plan switches were anticipated – almost double the historic 85,000-plus enrollment documents processed during the Open Enrollment campaign of 2001.

However, 90 percent of members who had to change plans for 2003 were able to stay with their primary care physicians. In those cases, members who switched to Blue Shield could keep their primary care doctors since most of them contracted with that plan.

In response to constituent calls for less paperwork to process, staff planned a streamlined Open Enrollment package containing a newsletter and two booklets about health plan comparisons and benefit summaries. Members were also provided with a pre-paid post card to request booklets about the health program, the quality and performance of health plans, and Medicare, if they wanted them.

### Customer Service

The Open Enrollment drives of 2001 and 2002 entailed expanded partnerships between our health staff and our Customer Call Center. To complement the phone process, an Interactive Voice Response (IVR) system and the CalPERS Web site were used. The IVR system allowed callers to get information without talking directly to a phone agent. In addition, our retired members were able to make health plan changes through both the

Internet and the IVR System, and there was expanded online information accessible for all our program participants.

A policy that allowed members to qualify for health plans based on their home or work ZIP code also was implemented. This provided even more range of choice in health plans. To assist employers in handling the requests of our active members, our Automated Communications Exchange System (ACES) allowed online registration of new members and access to existing member data for enrollment changes.

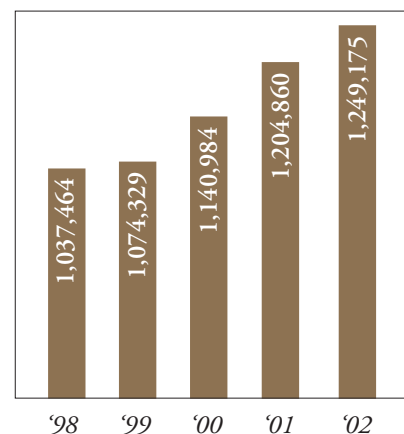
### PPOs Recover

The program's biggest success story of the 2001-02 fiscal year belonged to the CalPERS PPOs. Hit hard by spiraling health care costs, PERSCare and PERS Choice experienced low financial reserves in late 2000. But a recovery plan adopted by the CalPERS Board began to pay off. By April 2002, all four plans – PERSCare, PERS Choice, and their Medicare supplemental plans – recorded strong gains. The Basic PERS Choice plan gained 55,000 enrollees for 2002 and total enrollment in both PERSCare and PERS Choice approached 290,000.

For the first time since separate assets had been tracked for the PPOs, all four plans had assets in excess of basic reserve requirements.

### Total Health Program Membership

*Five-Year Review*



Their combined assets were enough to cover 2.6 months of claims and expenses compared with the calendar year target of three months.

### New Members

The CalPERS health program grew by 3.7 percent in the fiscal year ended June 30, 2002. Total membership included 1,249,175 active and retired public employees and their family members. In addition, a total of 1,084 public agencies participated in the CalPERS health program. (The total number showed a decline of 349 from 2001. During the year, CalPERS completed development of our COMET database system, which consolidates multiple employer contracts into one listing. Previously, each contract was shown as a separate employer.) Using the non-consolidated figures, the program gained 28 more agencies during the year. Total covered lives in the public

agency area accounts for 41 percent of total program membership.

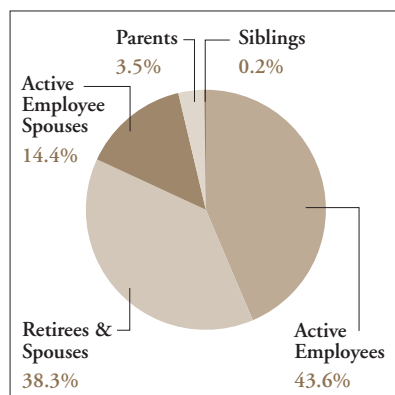
### The CalPERS Long-Term Care Program

The CalPERS Long-Term Care Program is as popular as ever, growing by more than 10 percent per year. At the close of the 2001-02 fiscal year, it covered more than 165,000 enrollees, up from 147,169 the year before. Most participants are active workers, and for the first time, adult siblings of public employees could enroll, in addition to employees' spouses, parents, and parents-in-law.

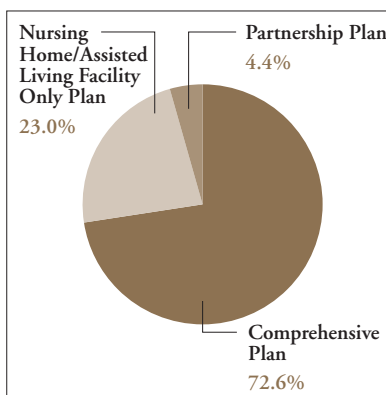
Long-term care covers personal, non-medical assistance in performing ordinary activities of daily living such as bathing; dressing; toileting; moving in and out of a bed, chair, or wheelchair; eating; and continence.

Our program provides three plan options: a Comprehensive Plan, a Nursing Home/Assisted Living Facility Only Plan, and a Partnership Plan. The Comprehensive Plan covers care at home or in a community, nursing home, or assisted living facility; the Nursing Home/Assisted Living Facility Only Plan covers care in a nursing home or assisted living care facility; and the Partnership Plan covers home, community, nursing home, and assisted living care, with a MediCal asset protection feature. Each plan includes care advisory services, respite care to provide short-term

### LTC Program Membership



### LTC Membership by Plan Type



relief to family caregivers, a premium waiver while receiving benefits, portability, inflation protection options, and guaranteed renewal from year to year.

At the close of the fiscal year, 72.6 percent of all enrollees were in the Comprehensive Plan; 23.0 percent were enrolled in the Nursing Home/Assisted Living Facility Only Plan; and 4.4 percent were in the Partnership Plan. Some 72 percent of enrollees had chosen automatic inflation protection, and 76 percent chose a plan with an unlimited lifetime benefit.

At the end of the 2001-02 fiscal year, annual premiums stood at \$186.6 million and benefits paid totaled \$31.5 million. The average annual premium was approximately \$1,228.

Although many companies arrange for long-term care coverage, CalPERS offers the nation's first self-funded, not-for-profit long-term care program, with plans that cost less than comparable commercial plans. Premiums are paid by the individual and are based on the age when the application is received. Benefits are tax-free, and premiums may be tax deductible under certain circumstances. The total coverage amount applies to all covered services, so members can use their benefits in whatever combination best meets their needs. In addition, the deductible period is counted in calendar days – not days of paid

service, enabling members to save money, while staying at home.

### Planning for the Future

Early in 2002, the Board began exploring new ways to continue the delivery of quality care at affordable prices for the next 10 to 20 years. Our guidelines were spelled out by Public Employees' Medical and Hospital Care Act, the 1968 law that emphasizes cost effectiveness, plan choice, plan stability, and quality of care.

In January, the Board affirmed those policy imperatives in response to market analysts' predictions for continued double-digit rate increases for the rest of the decade. As work began on a long-range plan, we determined that CalPERS should be a "shaper" of an improved level of care, rather than a "taker" of whatever the marketplace delivered.

To address cost, CalPERS will work to leverage the purchasing power of our large enrollee pool to obtain superior value, focus on the contributing causes of rising prices, engage enrollees in decision-making about their care and its costs, and give them incentives to do so.

Fewer, larger risk pools with longer-term contracts might produce more stable premiums, benefits, and service areas, and reduce variations in costs and market disruptions that have plagued members in the past. The CalPERS Board will

explore a wider choice of benefit designs instead of the "one size fits all" model of the current program.

Having fewer health plan partners might enable us to manage the program more intensely, advance more effective management of the chronic diseases that drive most of the costs, and reduce another major price driver – the use of wasteful, ineffective treatments that fail to meet standards of medically- and scientifically-proven best practices.

At the very least, the Board will try to provide a better level of care. That will be a victory for the program – even without a significant reduction in cost in the coming years.

#### Long-Term Care Program Highlights

- 165,128 participants
- \$1,228 is average annual premium
- \$186.6 million annual premium income
- \$31.5 million paid in benefits



*“Down cycles in the stock market  
and a flagging economy do not impact our  
ability to provide secure, stable pension benefits.”*



CalPERS  
Investments



*Every investor was impacted from events during this last year. CalPERS weathered the storm of economic recession, military conflicts, and a series of financial scandals. Still, our members remained secure, and we managed to realize better returns than many other pension systems. We stayed true to our continuing strategy of strong investment diversification, focusing on long-term investing, and pushing for corporate governance principles. During the year, we also built new alternative investment relationships; expanded our California investment commitments; and worked with other institutional investors to bring reform to the markets and restore investor confidence.*

### **Diversified Investment Portfolio Keeps Losses Under Control**

In what was one of the worst years for the U.S. financial markets, CalPERS found shelter in our well-diversified investment portfolio, and fended off substantial losses.

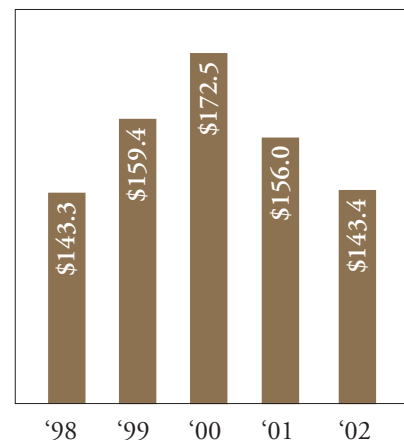
We achieved excellent returns on our real estate investments. The asset class earned 10.3 percent this past fiscal year, reducing the Fund's average losses to 6.1 percent in a bear market. The Retirement Fund ended the fiscal year with assets valued at \$143.4 billion.

Annually compounded over the last 10 years, the Fund returns were more than 9 percent. For the 2001-02 fiscal year, CalPERS loss hovered around the average loss experienced by other retirement systems. U.S. public pension systems with more than \$1 billion in assets lost more than 6 percent for the year ended June 30, according to a survey conducted by Wilshire Associates, based in Santa Monica, California.

Our long-term performance fared better than other public retirement systems. We earned a 5.3 percent annualized return for the 5-year

### **Growth of Investment Portfolio at Market Value**

*Five-Year Review (Dollars in Billions)*



period ended June 30, 2002, compared to the 5.1 percent return earned by other retirement systems. CalPERS earned a 9.3 percent annualized return for the 10-year period.

In the bond markets, our U.S. and international bond investments posted gains during the year. Our international bonds earned a 15.2 percent return, just shy of the 15.8 percent return posted by its benchmark, the Salomon Brothers Non-U.S. World Government Bond Index. Our U.S. bonds returned 6.0 percent, underperforming its benchmark, the Salomon Smith Barney Large Pension Fund Index, which gained 8.8 percent.

The bear market took back some investment gains from recent years, but our diversification policy and passively managed investment strategy paid off. Our U.S. stocks presented a 16.8 percent loss, but fared better than its industry

### Performance Benchmarks

<i>Asset Class</i>	<i>Benchmark</i>
<b>Fixed Income</b>	
Domestic	Salomon Smith Barney Large Pension Fund Index
International	Salomon Brothers Non-U.S. World Government Bond Index
<b>Equity</b>	
Domestic	Wilshire 2500 Index (Tobacco-Free Index)
International	Custom FTSE All World Index
<b>Alternative Investments</b>	15 Percent Hurdle Rate
<b>Real Estate</b>	NCREIF Property Index

### CalPERS Asset Allocation

<i>Asset Class</i>	<i>Market Value (\$ Billion)</i>	<i>Current Allocation</i>	<i>Current Target<sup>1</sup></i>	<i>Previous Target</i>
<b>Cash Equivalents</b>	<b>\$0.9</b>	<b>0.6 %</b>	<b>0.0 %</b>	<b>1.0 %</b>
<b>Fixed Income</b>				
Domestic	\$34.5	24.1 %	24.0 %	24.0
International	6.5	4.5	4.0	4.0
<b>Total Fixed Income</b>	<b>\$41.0</b>	<b>28.6 %</b>	<b>28.0 %</b>	<b>28.0 %</b>
<b>Equity</b>				
Domestic	\$53.8	37.5 %	39.0 %	41.0 %
International	27.4	19.1	19.0	20.0
Alternative Investments/Private Equity	7.0	4.9	6.0	4.0
<b>Total Equity</b>	<b>\$88.2</b>	<b>61.5 %</b>	<b>64.0 %</b>	<b>65.0 %</b>
<b>Total Real Estate</b>	<b>\$13.3</b>	<b>9.3 %</b>	<b>8.0 %</b>	<b>6.0 %</b>
<b>Total Fund</b>	<b>\$143.4<sup>2</sup></b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>100.0 %</b>

#### NOTES:

<sup>1</sup> Target allocation approved by the CalPERS Board of Administration in May 2000.

<sup>2</sup> Differences between investment values above and the values on the Summary of Investments on page 73 of the CAFR are due to differences in reporting methods. The Summary of Investments includes Net Investment Receivables/Payables.

benchmark the Wilshire 2500 Index (Tobacco-Free Index), which fell 17.4 percent. Our international stocks declined 10.2 percent, just below the 8.8 percent loss suffered by its Custom FTSE All World Index.

Our private equity investments posted a 7.1 percent loss, below its hurdle rate, but far better than the average private equity market. According to data released by Venture Economics, private equity investments lost 14.6 percent in the first nine months of the 2001-02 fiscal year.

At year end, U.S. and international public equities represented approximately 57 percent of CalPERS assets. U.S. and international bond investments represented almost 29 percent, real estate 9 percent, and private equity investments represented 5 percent of assets.

### Investment Policy & Strategy

Asset allocation is one of the most important decisions made by the CalPERS Board of Administration. In the long run, it is the way in which we diversify stocks, bonds, real estate, and other investments that determines our long-term performance. Studies have shown that more than 95 percent of the investment performance is attributable to the asset allocation policy of a pension plan.

The asset allocation plan is the working framework for the selection and weighting of asset classes. The CalPERS Board sets a strategic asset allocation policy and a range around the target allocations. Strategic asset allocation reflects that long-term outlook for each asset class. The Board sets tactical asset allocation ranges that enable investment managers to take advantage of buying or selling opportunities and provides the flexibility for day-to-day management.

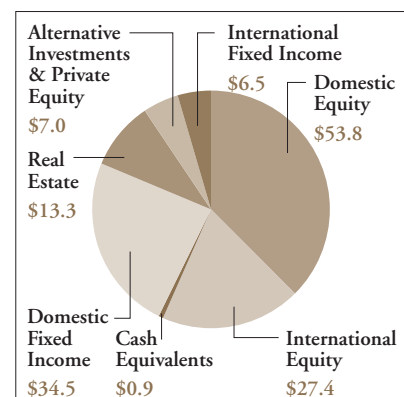
The CalPERS asset allocation mix is decided following an extensive review of a variety of factors. Economic scenarios of the global financial markets are simulated, and future liabilities and expected future contributions by employers are considered.

### CalPERS Investment Performance Goals

In addition to setting overall asset allocation policies, the Board also establishes investment policies for each portfolio, and annual performance benchmarks for each asset class. Investment policies are formally reviewed through the CalPERS Board's Investment Policy Subcommittee and receive final approval by the System's Investment Committee. Our investment policies for each asset class can be found on our Web site at [www.calpers.ca.gov](http://www.calpers.ca.gov).

### Allocation of Investment Portfolio at Market Value

*\$143.4 Billion (Dollars in Billions)*



### Alternative Investment Management (AIM) Program

CalPERS is one of the world's largest private equity investors. We maintain a strong, well-diversified, young portfolio with a focus on being the investor of choice in the private equity industry.

We continued that pursuit during the year as we built new investment relationships with top investors and enhanced our strategic investment vehicles. Our investment spectrum included seed capital, buyout and growth, distressed, mezzanine capital, and early- and late-stage venture capital. Our efforts generated nearly \$3.5 billion of cash profits for the CalPERS Alternative Investment Management Program, with an average investment age of only 2.9 years. As our portfolio matures, our AIM program is becoming self-financing.

Our AIM investment team has worked closely with our general partners to learn and understand key investment sectors that impact our portfolio. Two quarterly roundtables on biotechnology and health care services were held with our investment partners during the fiscal year. The informal gatherings provide an opportunity to exchange knowledge and foster ideas that help direct the future growth of our portfolio.

During the year, we teamed up with the Yucaipa Companies to establish a first-of-its-kind merchant bank holding company that will control subsidiary funds and businesses that provide financial services to public pension funds, Taft-Hartley pension funds, unions, and union members.

CalPERS committed up to \$560 million in the Yucaipa American Funds, a holding company that will tap the assets of Taft-Hartley plans, as well as public pension funds, and invest them in buyout and private equity investments. The relationship between CalPERS and Yucaipa included a \$35 million minority interest in the funds, and an initial \$250 million investment in business offered by Yucaipa, with an option for \$275 million in the future. The investments focus on industries and companies that maintain strong corporate governance practices and are sensitive to the interests of their employees.

#### A Closer Look at AIM

*Investments & Commitments (Dollars in Millions)*

<i>Portfolio Strategy</i>	<i>Active Commitments</i>
Corporate Restructuring	\$7,797.8
Distressed Securities	550.0
Expansion Capital	4,014.2
Mezzanine Debt	585.6
Secondary Interests	682.3
Special Situation	774.0
Venture Capital	4,978.1
Other	124.9
<b>Total</b>	<b>\$19,506.9</b>

We see tremendous opportunity in the Taft-Hartley community and in Yucaipa. According to industry reports, Taft-Hartley plans control more than \$400 billion in assets, but invest only one-tenth of one percent in private equity. Even a modest investment in private equity would represent tens of billions of dollars of capital, while providing an opportunity for them to diversify their investment pool.

The relationship also allowed us to be part of a growing and successful investment firm. Yucaipa has built a strong track record by working in partnership with employees and with communities in which it invests and operates. This record uniquely qualifies the firm as a trusted source for private equity investments.

The year also posed some challenges. We found ourselves in the middle of one of Corporate America's largest financial scandals. Enron Corporation imploded with revelations of improper accounting practices, alleged inadequate audits, mismanagement, and failure by the Board of Directors to perform its fiduciary duty to shareholders.

CalPERS partnered with Enron in 1993 to pursue investments in natural gas-related businesses and properties in North America. The partnership, Joint Energy Development Company (JEDI I),

received \$250 million in investments from both CalPERS and Enron. In November 1997, CalPERS sold our investment in JEDI I back to Enron for \$382.5 million in cash, resulting in a \$132.5 million gain.

The success of JEDI I was followed by the creation of a similar fund – JEDI II – that garnered \$500 million from CalPERS and Enron. The fund was in operation as the collapse of Enron began. CalPERS received back \$171 million on our investment in JEDI II, and continues to fully exit all of our Enron investments.

While the gains in our Enron private equity investments helped us offset losses we suffered in the public markets from the Enron collapse, the experience taught us many lessons. By definition, what went wrong at Enron was the result of hidden activity – relationships and financial dealings that weren't disclosed to (and possibly actively kept secret from) investors.

### Real Estate

A multi-billion dollar industrial real estate transaction topped our acquisition efforts this year, when we acquired all of the outstanding common shares of Cabot Industrial Trust with our industrial real estate partner RREEF. The total value of the all-cash transaction, including

Cabot's debt and preferred securities, was approximately \$2.1 billion.

During the year, CalWest Industrial Properties, LLC, the joint venture between CalPERS and RREEF, assumed ownership of more than 41 million square feet of warehouse, distribution, and workspace in 19 major metropolitan areas across the nation. The properties span the U.S. from Seattle to New York, including California cities such as Los Angeles, San Francisco, San Diego, and San Jose. The cities are expected to have the strongest long-term prospects, based on employment and distribution trends.

We captured a portfolio of high-quality industrial assets in strong markets, including markets in our own State. We added 360 industrial properties to our real estate portfolio, and gained considerable geographic diversity with a solid tenant base that made a terrific complement to our current industrial real estate holdings.

The year also marked a few firsts for our real estate portfolio. We made our first agricultural investment of \$100 million in Premier Pacific Vineyards (PPV), a Napa developer of premium vineyard lands for the fine wine industry. Up to 80 percent of the investment is targeted for California vineyards, while the remaining will be invested in land in Washington and Oregon.



The venture between PPV and CalPERS will acquire land, plant wine grapes, and harvest and sell the grapes over a 3-year period. The developed vineyard land will later be sold to wine producers within seven to 10 years. The deal was an important investment in the agricultural sector of California, as we affirmed our faith in the California's farmers and ranchers that make our State a leader in agriculture production.

We also completed our first major investment in the senior housing industry – a portfolio of seven assisted living facilities, including one in California.

The portfolio of properties, valued at approximately \$115.5 million, are owned and operated through a joint venture between CalPERS, our pension Fund's senior housing investment advisor, AEW Capital Management, based in Boston, Massachusetts, and Sunrise Assisted Living, Inc. (NYSE:SRZ) of McLean, Virginia. The seven properties we purchased are located in Carlsbad, California; Naperville, Illinois; Stanford, Connecticut; Richmond, Virginia; North Lynbrook, New York; and in East Brunswick/Woodcliff Lake, New Jersey.

Early in the fiscal year, we invested more than \$220 million in three premier shopping malls in the United States. The three shopping centers, located in California, Texas, and Illinois, total nearly 4.5 million square feet of retail space, including major department stores, theatres, and specialty shops. The properties were purchased through a newly formed joint venture between CalPERS and Rodamco North America, N.V. a Dutch publicly-held property investment company operating in the United States.

The properties include a \$69 million investment in Century City Shopping Center & Marketplace, based in the Century City area of western Los Angeles, California; a \$65 million investment in the Houston Galleria Shopping Center, centered in western Houston, Texas; and an \$88 million stake

### A Closer Look at Real Estate

*(Dollars in Billions)*

<i>Core Portfolio</i>	<i>Market Value</i>
Office	\$3.1
Industrial	3.1
Retail	2.3
Apartment	1.0
AFL-CIO BIT	0.1
Real Estate Investment Trusts	0.2
<b>Total Core Real Estate</b>	<b>\$9.8</b>
<b>Specialized Real Estate Portfolio (housing, timber, &amp; California urban infill)</b>	<b>\$2.5</b>
Specialized REIT — Extended Market <sup>1</sup>	0.7
<b>Total Specialized Real Estate</b>	<b>\$3.2</b>
<b>Total Real Estate</b>	<b>\$13.0</b>

#### NOTE:

<sup>1</sup> Net asset value for REITs exclude dividends.



in Oakbrook Shopping Center, located in a western suburb of Chicago, Illinois. The transaction allowed us to capture a profitable segment of the retail market by partnering with a leading retail property investment company.

Finally, we expanded our California Urban Real Estate Initiatives program in a move to harness the investment opportunities created by the growth of California's population and the shortage of affordable housing and general development in California's urban locations.

We selected four real estate investment partners to invest \$200 million in the development of real estate projects in California urban settings and earmarked \$150 million to establish a new affordable multi-family housing investment program by the end of the year. Our goal was to diversify our real estate portfolio in order to achieve greater returns while meeting a critical need for housing and development in urban localities. The investment partners focused on the development and redevelopment of multi-family units, single family housing, industrial, office and mix-used property types in urban settings.

We also approved a \$150 million affordable multi-family housing investment program that focuses on providing capital for the development of affordable housing

units. The action by our Board marked the first time CalPERS provided equity for multi-family affordable housing. The program includes projects with 70/30 and 80/20 market rate unit-to-affordable-unit ratios.

California's rapid growth is expected to provide new investment opportunities for our real estate partners and other developers in underserved areas. These new programs provide us with a diversified stable of partners that can canvas California's urban markets, and in return, make our real estate portfolio stronger.

### Global Public Markets

It was a volatile year in the public markets, as most investors continued to give back some of the superior returns earned in the stock market in recent years. The year also began with many uncertainties in the public markets, as the confidence of investors and Americans were rattled after the events of September 11, 2001.

Two days after the attack, CalPERS and the nation's other large public pension funds expressed strong support and full confidence in the U.S. financial systems and markets. We urged investors to remain calm and we assured them that we would continue to provide stability in the U.S. capital market as a patient long-term provider of

capital. We supported the efforts of stock exchange officials and members to reopen the markets in an orderly manner. More importantly, we kept our focus, and continued about our service to our members.

We completed more than \$7 billion in funding to a line-up of new active international managers, and we funded a \$1 billion internal currency overlay portfolio. We established policies for our hedge fund program, and completed searches for active emerging market managers, active domestic equity growth managers, a passive international equity manager, and a new stable of high yield managers.

CalPERS also completed a comprehensive review of emerging market countries with which we invest public equity. The result was a new investment strategy model that takes into account broad financial factors as well as transparency, political stability, and labor practices and standards.

Our review of the emerging markets is believed to be the first of its kind by a public pension fund that looks beyond traditional economic factors and considers basic democratic principles. Based on the review, we began taking a public equity position in Poland and Hungary, while eliminating our public equity investment position in Indonesia, Malaysia, and Thailand.

We believe we now have in place a blueprint to examine which emerging markets can support institutional investment. Our model is a screen and an important entry point for investments into our portfolio that will help to protect our members' assets in the emerging markets.

We recognize that our new model in the emerging markets is subject to change. Many reforms have been made in recent years in the emerging markets that have increased their appeal to foreign investors. We intend to reevaluate our model as the emerging markets change and develop over time.

We also hired five investment firms to manage up to \$1.5 billion in high yield investments. These managers will provide broad diversity in the high yield investment market and help us develop some internal expertise in this arena. Our goal is to develop an in-house investment team to manage some, or all, of the portfolio internally in the next three years.

## Corporate Governance

Everyone – from large institutional investors to individuals – was impacted from not one, but many corporate crises. Together they created a crisis of confidence in American business.

Enron's demise and the crises at WorldCom, Tyco, and Adelphia have focused attention on a wide spectrum of problems where America's corporate governance must be strengthened. It has taught us that shareowner value can be destroyed by faulty corporate governance.

We believe Enron's collapse will have lasting repercussions far beyond the world of energy and commodities trading. It is important that corporate America embrace meaningful reform. Our goal is to act in concert with other shareholders to help bring that reform to the markets and restore investor confidence.

During the year, we put our own financial market reform action plan together. We worked with the U.S. federal government and stock exchanges to take actions that will:

- elevate the quality of company audit committee members;
- create clear and effective laws and regulations that will ensure company audits are truly independent; and
- develop accounting standards

### A Closer Look at Global Public Markets

*(Dollars in Billions)*

	<i>Domestic</i>	<i>International</i>	<i>Total</i>
Fixed Income	\$34.5	\$6.5	\$41.0
Equity	53.8	27.4	81.2
<b>Total Global Public Markets</b>	<b>\$88.3</b>	<b>\$33.9</b>	<b>\$122.2</b>

## International Equity & Fixed Income Investments

### Country Diversification

#### *Up to \$25 million*

Argentina	Israel
Bermuda	Papua New Guinea
Cayman Islands	Peru
Croatia	Philippines
Czech Republic	Swaziland
Gabon	Thailand
Hungary	Turkey
Iceland	

#### *\$25 to \$50 million*

Chile	New Zealand
Indonesia	

#### *\$50 to \$100 million*

Austria	Malaysia
Greece	Poland
Luxembourg	

#### *\$100 to \$300 million*

Brazil	Portugal
Ireland	Singapore
Mexico	South Africa
Norway	Taiwan

#### *\$300 to \$500 million*

Belgium	Finland
Denmark	

#### *\$500 million to \$1 billion*

Australia	Spain
Hong Kong	Sweden
Korea	

#### *More than \$1 billion*

Canada	Japan
France	Netherlands
Germany	Switzerland
Italy	United Kingdom

that will put an end to “unintelligible or manipulative” financial statements that confuse or even deceive investors.

We actively opposed the election of any director who, while sitting on a company’s audit committee, approves retaining an external audit firm when that firm also provides consulting or internal audit services to a company. We also publicly opposed shareowner approval of any auditor that has been retained by a company for more than five years.

We also joined other institutional investors to urge the passing of the Sarbanes-Oxley Act. It is now a U.S. law that provides much needed auditor independence and accounting oversight – and ultimately provides greater confidence in the accuracy of financial reports. The new law also increases penalties for mail, wire, and pension fraud. It adds new criminal penalties for corporate financial fraud and obstruction of justice involving shredding documents. More importantly, it creates a regulatory board to oversee the accounting industry and punish corrupt auditors.

We also kept the pressure on companies in our investment portfolio. We released our Focus List of companies that represent some of the worst examples of poor financial and governance

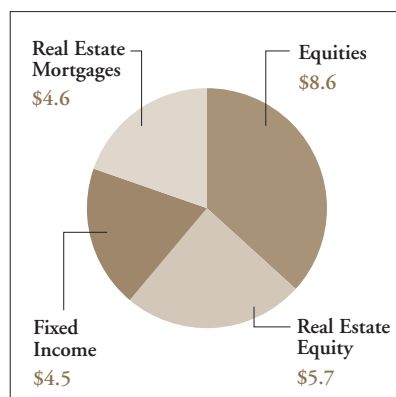
performance. The 2002 list included:

- Lucent Technologies of Murray Hill, New Jersey;
- NTL, Inc. of New York, New York;
- Qwest Communications of Denver, Colorado;
- Cincinnati Financial Corporation of Cincinnati, Ohio;
- Gateway Computers of San Diego, California.

CalPERS pushed a variety of corporate governance improvements at these companies in an effort to generate better returns and long-term performance. Several companies agreed to corporate governance changes, including electing independent directors, appointing lead independent directors, conducting board self-evaluations, and adding independent directors to the company’s audit, compensation, and nominating committees.

### CalPERS California Investments at Market Value

*\$23.4 Billion (Dollars in Billions)*



### California Investments

CalPERS investments are a critical part of the economic fabric of California. Our record of investing in California extends back to the early 1980s, with investments in real estate mortgages and real estate equity. Our California investment portfolio has grown steadily. As of June 30, 2002, approximately \$23.4 billion

was invested or earmarked for investment in California.

California investments are part of each asset class in our investment portfolio and are expected to deliver a return commensurate with similar investments of comparable risk. Our Board considers California investments – and all other investments as well – on the sole basis of investment merit. Investments must be financially comparable to other available investment alternatives. The CalPERS Board judges comparability on a risk-adjusted basis. Under existing policy, we will accept no less in return, and may incur no additional risk or cost, for a California-oriented investment.

Investments in California may have the ancillary benefit of creating jobs, housing, and improvements to the State's general infrastructure, and more

importantly, serve the broad interests of CalPERS members. By strengthening the State's economy and the well being of our employers, California investments help promote the continued ability of employers to make contributions to the System.

Today, we invest nearly \$7 billion in companies that make their home in California. These include established publicly-traded corporations and young entrepreneurial businesses that rely on CalPERS private placement capital for growth and expansion. Our fixed income assets, largely held in corporate bonds, total approximately \$581 million. We have earmarked nearly \$1 billion for real estate development and redevelopment in urban areas of California. And our Member Home Loan Program, implemented in 1989, has made more than 71,000 real estate loans, totaling more than \$13.8 billion.

CalPERS no longer produces a separate Annual Investment Report. All the information previously included in that separate volume is now contained in this Operations Summary and the accompanying Comprehensive Annual Financial Report. A complete listing of all portfolio holdings is available on the CalPERS Web site at [www.calpers.ca.gov](http://www.calpers.ca.gov).

*“We work to ensure the interests of  
our members and employers are  
addressed in both the State and national legislative arenas.”*



Legislative  
Highlights





*CalPERS administers benefits that are defined in current law and regulations, and proposes changes in these areas to ensure equity for our customers, and security of our retirement and health programs and services. At the national level, we advocated for better corporate governance and accountability and reduced securities trading costs, and monitored ongoing discussions on Social Security and pension protections.*

### Federal Update

Our federal relations program continued to ensure that the interests of the System, our members, and our contracting employers were addressed in the overall federal policy-making process in 2001-02. CalPERS was involved in initiatives covering a variety of corporate accountability, investment, and pension and health benefit reform matters during the year.

CalPERS-backed legislation designed to reduce the cost of securities trading was among the

first bills signed into law at the start of 2002. Passed by both chambers in late-2001, President Bush enacted the legislation on January 16, 2002. The measure is expected to save investors millions of dollars and beef up enforcement by the Securities and Exchange Commission (SEC). CalPERS Chief Executive Officer, James E. Burton, testified in support of the legislation in February 2001.

In the wake of the Enron and WorldCom scandals, corporate governance and accountability

took center stage for most of the first half of 2002.

CalPERS demonstrated our leadership on these issues, providing Congress strong support of comprehensive legislation. CalPERS staff testified before Congress and a letter of support was written to Senate Banking Committee Chairman Paul Sarbanes, which was included in the final committee report. Our Board of Administration attended a half-day discussion on the issue, which featured several prominent speakers, including current SEC

Commissioner Harvey Goldschmid, a former SEC director, and a key Banking Committee staffer. With CalPERS help, the Sarbanes-Oxley Act was enacted into law on July 30, 2002.

Other private pension protections have also been debated in Congress that could adversely impact public sector defined benefit plans such as CalPERS by imposing new federal laws and penalties for certain information and notices already being provided under State law. Nevertheless, it remains unclear whether Congress will have time to pass a pension reform bill before it adjourns.

The growing awareness of the rising costs for prescription drugs, especially for the elderly, continues to be a major health care issue for Congress and the White House. The House passed a limited Medicare prescription drug benefit, but negotiations in the Senate failed, and it appears unlikely that any new drug benefits will be added to Medicare this term. Other approaches to skyrocketing drug prices include improving the

process for getting generic drugs on the market faster and allowing certain U.S. manufactured drugs sold in Canada to be reimported at lower prices than medicines sold in the U.S. These efforts have had mixed results. The Senate passed legislation on these proposals, but the House has not.

Social Security reform remained off the table for most of 2002, following the release of the report by the President's Commission to Preserve Social Security in December 2001. For the first time in over a decade, a Social Security working group did not include mandatory coverage as an option for helping resolve the long-term solvency problem. Despite this victory, reform efforts will re-emerge in 2003.

Other CalPERS initiatives such as long-term care tax breaks, enhanced bankruptcy protections for participants, Government Pension Offset reform, and Windfall Elimination Provision reform fell by the wayside, as other federal priorities dominated the legislative calendar in 2002.

## State Legislative Update

The following is a brief summary of some of the CalPERS-related legislation enacted during the second year of the 2001-02 Session of the California Legislature. (New laws become effective January 1, 2003, unless otherwise noted.)

### A.B. 1908, Chapter 871 (Cohn)

Eliminates the requirement that only participants in the CalPERS Long-Term Care Program can pay the full cost of enrollment, allowing employers to contribute toward premium costs.

### A.B. 1974, Chapter 1133 (Pescetti)

Allows the CalPERS Board of Administration to determine the criteria under which local public agencies with less than 100 active employees must participate in a risk pool. Facilitates participation by school employers, defines school members as local miscellaneous members, and makes them eligible for benefits applicable to local miscellaneous members (when the school member is employed by a school employer participating in a pool).

### A.B. 2549, Chapter 1045 (Nation)

Provides CalPERS membership for temporary California State University (CSU) faculty who have at least six weighted teaching units or more, subject to collective bargaining agreement, or authorized by CSU trustees for those excluded from collective bargaining.

### S.B. 1464, Chapter 896 (Soto)

Incrementally increases the minimum employer contribution for public agencies contracting with the CalPERS Health Program from \$16 per month per member up to \$97 for the 2008 calendar year. After 2008, the minimum employer contribution would be adjusted annually to reflect changes in the medical care component of the Consumer Price Index.

### S.B. 1536, Chapter 898 (Soto)

Increases the Board's authority to respond to health care challenges, reduces the impact of adverse selection within the CalPERS program, and provides the Board with the ability to assess interest and penalties on contracting public agencies that fail to pay their contributions on time.

### S.B. 2094, Chapter 546 (Senate PE&R Committee)

Allows CalPERS members to purchase up to three years' service credit for the time they served as a volunteer in AmeriCorps. The same option already is allowed for military service, time spent on maternity or paternity leave, and for Peace Corps or VISTA service.

*“In this rapidly changing world,  
we’ll continue to explore our customers’ needs,  
how we can do our work even better, and  
the services that bring the most value.”*



The Year Ahead



*Our single highest priority in the coming year will be protecting the funds that we hold in trust and delivering benefits promptly. These are of paramount importance. We'll also stay focused on increasing our customer services, expanding our asset management capabilities, and improving our benefit delivery systems. With our sound financial structure, a solid business plan, and our dedicated staff, we're committed to achieving superior results.*

In fiscal year 2002-03 we will continue to follow our Three-Year Business Plan, which guides our efforts to reach measurable improvements in customer service and benefits and asset management. Our next steps will include harnessing new technologies, continuing to streamline our business processes, and keeping our eye on the long-term horizon of changes for our industry and in the world around us.

New economic and demographic developments are taking place that will provide both important opportunities and challenges for

CalPERS. Our membership continues to increase and those members are living longer, the "baby boomers" as a group are reaching retirement age, there is a tighter fiscal environment for public sector employers, our economy is continuing to see less than stellar financial returns, and corporate America faces more stringent governance and oversight. Our plans are simple. We will remain aggressive in terms of increasing our customer services, expanding our asset management capabilities, and improving our benefit delivery systems.

In our customer service initiatives, we will continue our re-engineering efforts to provide both members and employers the best service in the most efficient way possible. In the coming year, we will be working on our Customer Relationship Project – developing a primary point of customer contact (both members and employers) from all sources: phones, e-mails, letters, as well as visitors to our offices. This business process project will enable us to reach our vision for a complete customer contact center. This effort will integrate new technologies with our existing systems, take advantage of recent

achievements in our Customer Call Center, and provide improved services to both our members and employers.

We'll complete our work on a new online service that will enable members to change or update their address and phone information through the Internet. We'll provide continual education for employers on ACES. Employers reap immediate benefits when using ACES.

This last year, we asked our members and employers how they felt about e-business at CalPERS and found that they want expanded online services and will use them if available. We learned that when they need something from CalPERS they don't want to wade through information that doesn't pertain to them. As a result, we are hard at work on developing our site to be a valuable customer resource, with information tailored to each membership and employer group, easy to use navigation, and seamless transition to our online services.

In the benefits management arena, we will be working on three main projects in the coming year – business solution workflow, the next extension of our COMET database system, and a health care decision support tool. The Workflow Project is a continuation of our recently completed Records Retention Project that will now include imaging employer records. Having a new digital environment lays the

foundation for future business improvements, reduces our costs, and improves service in many ways.

Customer service at the initial point of contact will be improved, physical storage space will be reduced, and our response time will be "real time." We will be able to complete more internal processes electronically and be able to better track our work, with reduced risk of lost or misplaced information.

The next phase of COMET integration will address the Contribution Reporting System and the Employer Reserve System. Moving these systems into COMET will not only assist us in our employer service areas, but will also have a domino effect that will enable us to keep employer payroll and member information updated. The end result impacts our ability to provide more accurate Annual Member Statements, move members into retirement quicker, and reduce post-retirement benefit adjustments. It also reduces the number of manual tasks staff have to complete to keep our records in order. We've already completed our procurement phase, and during the coming year, we will be moving to data clean up and conversion, system design, and the final technology build.

We will also be continuing on a project that will enable us to better serve our customers by providing education services that

are more relevant and responsive to their needs. While we will continue to offer our workshops and seminars throughout the State and our retirement counseling services, we want to make them more specific to the needs of our various member groups and more relevant to their career life cycles. And, we will be looking at options to reach more members earlier in their working career. To make sure we provide delivery methods that are more convenient to members, we will explore how many of the new technologies available today can assist in these efforts. These may include remote conferencing, computer based training which offers self-paced instruction, or expanding the retirement planning tools and services on our Web site.

Another primary focus for CalPERS during the year will be the continuation of our efforts to combat the rising costs and instability being experienced in our Health Program. Our Health Program Strategic Plan will guide us in instituting meaningful changes in the health care purchasing arena, here in California and the nation as a whole. It proposes to do so by "increasing the value proposition" of our program. This includes making our members more aware of the costs of health care; focusing quality and price competition at the provider level and plan competition on effective management of care and overall



costs; implementing and rewarding effective disease control programs; supporting system changes to improve health care delivery; and enabling our members and other health care consumers to take a more active role in their health care decisions.

In the longer-term, the plan proposes better-managed care by changing the fundamental incentives and interactions between patients, providers, plans, and purchasers. We look to have a more collaborative role with other care purchasers in securing the fundamental reforms that aim at reducing costs and broadening coverage.

The last major customer service initiative will be the development of a Health Care Decision Support System. This project will provide the technology we need to help address our critical Health Program needs. With this system, staff will be able to determine the health care needs of any targeted member group. It will include benefits usage data from our health plans and enable us to address critical areas of reform as we design and implement a more robust and enduring health benefits program. We will have the information we need to create the right program for our members, and to be a better negotiator with contracting providers.

In the asset management arena, we'll be working on three major

areas. First, CalPERS has adopted a new asset allocation model that will guide all our investment decisions. This new asset allocation mix continues with equity investments for the long term and calls for a 1 percent increase in our real estate and private equity programs.

The second area of focus in the coming year is the Risk Management System. This is a large-scale, enterprise project to develop and deploy a framework for the measurement, monitoring, and management of risk in our investments. This new product will integrate our existing investment management systems and once implemented will deliver timely risk reports to decision-makers who can use them to assess alternative investment opportunities. It will enable us to realize a higher return rate for the Fund by taking on higher levels of "managed risk."

And finally, our next asset-related initiative is the continuation of our Straight Through Processing Project (STP). The goal of this project is to establish a trade process that is automated, integrated, and operates in real time. This integrated processing system will comply with any future compressed settlement process, significantly improve our business practices, and ensure CalPERS ability to participate in changing financial markets. STP will eliminate redundant processes

and reduce trading error rates, as well as the number of manual steps required to settle transactions. Investing in a fully-integrated processing system that operates at, or close to, real time will allow CalPERS to monitor the status of trades at any point during the settlement cycle. It will also provide an opportunity to reduce counterparty risk, prevent costly trade failures, and ensure compliance with our policies and directives.

Another area we will be working on in the coming year addresses our continuing efforts to ensure that the limited funding for public sector benefits available – taxpayer dollars – are used in the most economically sound, prudent manner. CalPERS employers bear the responsibility to ensure that there are sufficient funds to pay for member benefits. If employer contributions are too unpredictable, then there will be pressure to change the benefit structures in ways that may not be best for members. One way we can assist is by developing a risk pooling approach. The Board of Administration approved this process in concept last year, and we are proceeding with implementation. This process involves the pooling of actuarial gains and losses between plans with similar benefit structures, which reduces the volatility of employer rates due to adverse demographic events. It requires

a lot of imagination and modeling of possible scenarios to ensure that the results will be equitable for all employers without defeating the purpose of pooling. We hope this approach will be efficient and effective, and improve employer satisfaction.

With these aggressive plans in place to meet our strategic

objectives, we also know that it is critical to continue excellence in our day-to-day business processes. Along with the dedicated staff doing the daily work to administer our benefit programs, we have people in place answering phones in a timely manner, educating and providing information to both employers and members. We

will support our employees and give them the resources they need, advocating for our customers in the State and federal legislative arenas, keep our computer systems humming, and balance all our accounting records.

This is much to accomplish – and we look forward to the challenges that lie ahead.



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